

How Do Emotions Affect Ethical Evaluations for Accountants?

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ABSTRACT

There is a significant amount of research and models on ethical decision-making processes; however, there is limited research on how emotions affect ethical evaluations and decisions in an accounting context. Prior research suggests that emotions may shape ethical evaluations and choices made by individuals. This study contributes to the accounting literature by exploring the emotions an accountant may feel when evaluating earning manipulations. This study finds that accountants feel regret when evaluating earnings manipulations.

Keywords: Accounting ethics, ethical decision making, emotions.

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INTRODUCTION

There is a significant amount of research on ethical decision-making processes. Loe *et al.* (2000) provides a comprehensive overview of the literature. Rest (1986) proposed a four component model describing moral behaviors as (1) moral sensitivity, which is the ability to identify a moral problem, (2) moral judgment, which is the ability to analyze a moral problem and make a moral decision, (3) moral motivation, described as the valuation of competing factors involved in making a moral decision, and (4) moral character, which are the moral attributes and courage that one would possess to act on a moral decision. Jones' (1991) extended Rest's model to discuss an issue-contingent model of moral intensity. Jones (1991) suggests that moral intensity affects moral decision-making and behavior. Another stream of research is based on Trevino's (1986) interactionist model, which examines the effects of individual and contextual factors on ethical decisions. However, neither of these models addresses the role of emotions and their effects on ethical evaluations and intentions.

Empirical studies have found emotions to be an important part of decision-making. Baron reported, "...in many situations, people think that their emotional reactions will fall into line with their normative beliefs. In other situations, some people think that their emotional reactions have a life of their own. [Baron] suggested that both normative beliefs and anticipated emotions affect decisions (1992, 320)." A study by Mellers and McGraw found that "research in decision making has demonstrated that anticipated pleasure improves the predictability of choice over and beyond utilities (2001, 213)." Coughlan and Zeelenberg (2002) reported that justifications are important in connecting certain emotions to decision-making processes. Klein argued "that emotions can help to resolve certain ethical dilemmas (2002, 347)."

Certain studies have explored the variety of emotions which exist in the making of ethical decisions. Gaudine & Thorne developed a model illustrating how emotion affects the various components of the ethical decision-making process. Their model integrates "the two dimensions of emotion, arousal and feeling state,

into an applied cognitive-developmental perspective on the process of ethical decision-making...[and] demonstrates that certain emotional states influence the individual's propensity to identify ethical dilemmas, facilitate the formation of the individual's prescriptive judgments...and promote the individual's compliance with his or her ethical decision choices (2001, 175).” A study by Coughlan and Connolly (2008) made a connection between business ethics research and decision research by examining the effects of justifications and emotions upon ethical decision-making, finding that “both the anticipated emotions associated with choosing each option and the judged relevance of particular justifications to each specific situation help shape the choices made by individuals facing ethical dilemmas (2008, 354).”

There are few studies examining the effects of emotions in an accounting context and none known that examine emotions in earnings management situations. Researchers suggest that affective reactions can influence decision making in accounting contexts (Moreno, Kida, and Smith, 2002). This current study is theoretically based on Rest's model and extends the literature of Coughlan and Connolly by exploring the effects of emotions on practicing accountants in performing an ethical evaluation in the area of earnings management.

The remainder of this paper is divided into four sections. The literature review section provides the theoretical foundations for the study and discusses earnings management and emotions, concluding with the hypotheses. The second and third sections provide the methodology and results. The fourth section reports on the results, and provides suggestions for further research.

LITERATURE REVIEW

Earnings Management

There are a variety of pressures to manage earnings, including when meeting analysts' expectations (Burgstahler and Eames 1998, and Kasznik 1999), prior to a management buyout (DeAngelo 1988), to

improve results preceding initial public offerings (Teoh *et al.* 1998a), in the process of making equity offers (Teoh *et al.* 1998b), and during stock-financed acquisitions (Erickson and Wang 1998).

Although not all earnings management is illegal, it is easy to slip from common and legal forms of earnings management to illegal manipulations. Stice and Stice (2006) discuss five levels of earnings management. The first type of earnings management in their continuum is “savvy transaction timing” where accountants make extra efforts to ensure that transactions are recognized in the most advantageous quarter. The second level on the continuum is changing methods, or estimates with full disclosure. This second type of change is common; however, it can be used to manipulate reported earnings. The third type of earnings management is “deceptive accounting,” where accountants change methods or estimates with little or no disclosure. The fourth type of earnings management is “fraudulent reporting” and has also been referred to as “non-GAAP accounting.” The final activity level in the earnings management continuum is “fraud,” which is defined as “fictitious transactions (Stice and Stice, 2006, 349).”

Crumbley *et al.* (2005, 2-10) defines fraudulent financial reporting as “manipulation of financial statements to misrepresent losses, expenses, and other bad news to investors and customers.” The purpose of this study is, “Do emotions impact ethical evaluations for earnings management situations?” This study extends the earnings management literature by exploring the impact of emotions on two ethical dilemmas related to earnings management.

Emotions

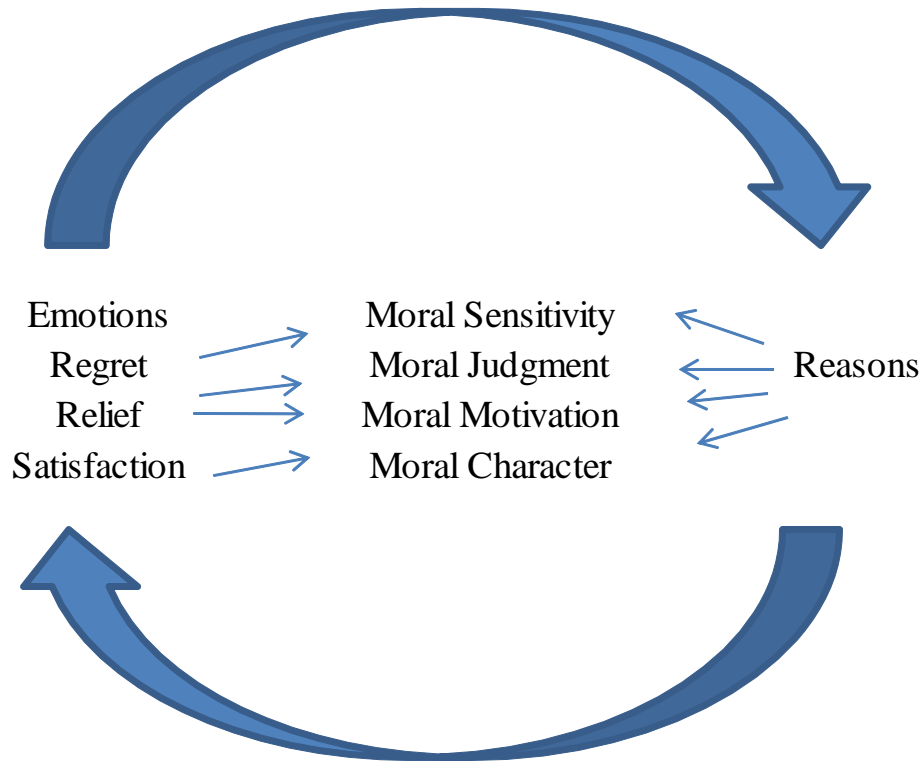
Cacioppo and Gardner, in 1999, performed a search using PsychInfo on the word “emotions,” and found 5,064 citations in a five year period. What are emotions and how can they affect the ethical decision-making process? Callahan (1988, p.10) defines emotions as, “distinctly patterned human experiences that, when consciously felt produce qualitatively distinct subjective feelings and predispositions.... Emotions and thinking are, in sum, complementary, synergistic, parallel processes, constantly blending and interacting as a

person functions.” Etzioni proposed a model for decision-making which views individuals as rational actors who are deeply affected by their moral and emotive values (1988, xi). Etzioni suggests our choices are largely, if not completely, based on values and emotions, which may entirely account for the choices made. At the least, according to Etzioni, our values and emotions significantly shape our choices.

Greenfield (2007) extends Rest’s (1986) work describing a conceptual model of factors that influence moral behavior, shown in Figure 1. Greenfield identifies that “all emotions are responses to perceived challenges, threats, and opportunities that may alert us to a moral issue....emotional responses to moral issues and dilemmas often influence our moral sensitivity and moral judgment, and often motivate moral behavior” Greenfield (2007, p.15).

As previously mentioned, moral sensitivity involves the ability to identify that a situation involves an ethical problem. Moral judgment describes the morally right thing to do, or, in other words, what should be done. Moral motivation involves the importance of moral values in competition with other moral values. Moral character involves the strength of conviction and courage an individual possesses. A person may be morally sensitive, have the ability to make good moral judgments, and have high moral values, but may concede to peer pressure (lacking moral character). This study explores the impact of emotions (regret, relief, and satisfaction) on moral judgment.

Figure 1. A conceptual model of factors that influence moral behavior



A variety of emotions are part of the ethical decision-making process (Gaudine & Thorne 2001; Klein 2002). Researchers in the field of decision-making have contributed to the stream of research that supports the role of emotions in shaping the choices of individuals (Gilbert & Wilson 2000; Mellers *et al.* 1999). It is reported that there are beneficial and detrimental effects of real and anticipated emotions on decision-makers (Brief & Weiss 2002; Cacioppo & Gardner 1999). Also, the link between expected emotions and choice has been established (Melleter & McGraw 2001; Mellers *et al.* 1999).

There are few studies that focus on emotional reactions in an accounting context. Moreno, Kida, and Smith (2002) surveyed 121 practicing managers using scenarios in which participants had to choose one of two alternatives in a capital-budgeting context. Their results indicate that both positive and negative effects significantly affected managers' decisions. In general, the managers tended to avoid negative effect

decision alternatives and chose positive effect decision alternatives. Coughlan and Connolly investigated “the role of affective factors in the ethical decision-making process of individuals, while simultaneously exploring the justifications cited as important in the resolution of ethical dilemmas (2008, 351). Based upon Etzioni’s belief that emotions are the primary factor in choosing between alternatives (1988), Coughlan and Connolly presented three scenarios of business-related ethical problems to 184 students, and asked the subjects (1) how they should and would resolve the issue at hand, and (2) how they would feel about selecting each option, using questions to measure three emotions: regret, relief, and satisfaction.

Relief

Relief is the feeling experienced when one is no longer burdened by a stressful situation (Ortony *et al.* 1988). Relief has been found to motivate individuals to act in particular ways (Ekman 1999), especially in situations that include fear or anxiety, such as an ethical dilemma. Coye (1986) found that decision makers experience anxiety as they weigh alternatives and potential outcomes in ethical dilemmas. Levy and Dubinsky (1983) found that reducing or avoiding anxiety in making a thoughtful choice can lead to a feeling of relief. Coughlan and Connolly (2008) found that, at least in some situations, anticipated relief associated with acting appropriately can help in the decision to choose an ethical alternative. This study explores the effects of two problematic earnings management manipulations. Therefore, we hypothesize that:

H1 A practicing accountant will not feel relief when earnings are manipulated in order to gain corporate and/or personal benefit.

Regret

Zeelenberg (1999, 325) defines regret as, “...a negative, cognitively based emotion that we experience when realizing or imagining that our present situation would have been better had we acted differently.” The effects of regret on choice have been established in the area of consumer behavior (Inman

et al. 1997; Simonson 1992; Tsiros & Mittal 2000). Connolly and Reb (2004) found regret to affect decision-making in the area of medical treatment choice. Specifically, parents chose to vaccinate or not to vaccinate their children because of the regret respondents expected to feel if vaccination or non-vaccination led to a poor outcome. Pieters and Zeelenberg (2005) utilized a three-part longitudinal study of voters in national elections in the Netherlands and noted that regret impacts voting decisions. Coughlan and Connolly (2008) found that, at least in some situations, anticipated regret associated with acting inappropriately can help in the decision to choose an ethical alternative. This study explores the effects of two problematic earnings management manipulations. Therefore, we hypothesize that:

H2 A practicing accountant will feel regret when earnings are manipulated in order to gain corporate and/or personal benefit.

Satisfaction

The word “satisfaction” comes from the Latin words “satis,” meaning “enough,” and “facere,” which means “to do or make.” Oliver states “that satisfaction implies a filling or fulfillment, perhaps up to a threshold of undesirable effects (1997, 11).” Decisions are affected by the satisfaction expected after a decision is made (Houston *et al.* 1991; Oliver 1997). Houston *et al.* (1991) conducted an experiment: they first paired items that shared good features and had unique bad features (which they called “unique bad pairs”) then paired items that shared bad features that had unique good features (which were called “unique good pairs”). Satisfaction was greatest in the unique bad pairs when the focus was on the rejected alternative. Satisfaction was greatest in the unique good pairs when the focus was on the accepted alternative.

There are few, if any, empirical studies in business ethics which have included measures of expected satisfaction with possible outcomes. Coughlan and Connolly were unable to support that the emotion of

satisfaction affected the decision to choose an ethical alternative, although they posit that “the value of anticipated outcomes clearly plays a substantial part in many decisions, and the role of anticipated satisfaction should not be ignored (2008, 350).”

This study explores the effects of two problematic earnings management manipulations. Therefore, we hypothesize that: This study explores the effects of two problematic earnings management manipulations. Therefore, we hypothesize that:

H3 A practicing accountant will not feel satisfaction when earnings are manipulated in order to gain corporate and/or personal benefit.

METHODOLOGY

A survey was presented to continuing professional education seminar participants in four seminars sponsored by a state society of certified public accountants. Excerpts of the survey are provided in Appendix A. Of the 957 attendees, 192 agreed to participate in the study (a 20.1% response rate). Incomplete surveys were eliminated, leaving 171 usable responses. There were 109 male respondents and 62 female respondents. Nearly all of the participants (168 or 98%) identified themselves as CPAs. The average experience for the participants is 26 years (12 standard deviation) and Table I provides demographic data by age ranges.

The study utilized a 7-point Likert scale to answer questions about two scenarios. The scale ratings ranged between 1, “strongly agree,” to 7, “strongly disagree.” Each participant was asked whether or not the situation involves an ethical problem and whether the actor in the scenario should perform the act. The first situation is a controller adjusting bad debts in order to manage earnings (called “bad debt”), and the second is

of a manager shipping a product early to receive a quarterly bonus (called “early shipment.”) Each participant responded to three questions for each situation, identifying emotions their peers would feel if the controller or manager completed each action. They rated feelings of relief, regret, and satisfaction on a 7-point Likert scale ranging from 1, “my peers wouldn’t feel this at all,” to 7, “my peers would feel a great deal of this.” Izraeli (1988) found that managers, in general, rated themselves more ethical than their peers when evaluating ethical beliefs and behaviors. To eliminate possible social desirability response bias, survey questions were worded in the third person. Table II provides the means and standard deviations for the variables, and Appendix A includes the earnings management scenarios and the questions that the participants used to evaluate each situation.

RESULTS AND DISCUSSION

The participants indicated that each scenario represents an ethical problem (bad debt mean of 1.888 with a standard deviation of 1.508, early shipment mean of 2.000 and a standard deviation of 1.465.) The participants indicated that the controller in the bad debt scenario and the manager in the early shipment scenario should not complete each action (bad debt mean of 2.311 with a standard deviation of 1.509, early shipment mean of 2.060 and a standard deviation of 1.466). Participants are more likely to feel regret if the actions were completed (responses were in the mid-range of the scale) in comparison to relief and satisfaction (responses were closer to 1).

A hierarchical regression attempts to predict the effects of emotions on ethical evaluations of whether the manager or controller in each scenario should complete the action. The first step in each regression is the evaluation of whether or not there is an ethical problem for each scenario. The second step in each regression includes evaluations of the emotions (relief, regret, and satisfaction) one would feel if the action

in the scenario is completed. Table III presents the results for the early shipment scenario and Table IV presents the results for the bad debt scenario.

In both scenarios, identifying an ethical problem is statistically significant to evaluating whether the action in each scenario should be completed. In both scenarios, regret is statistically significant when making a moral judgment about earnings manipulations. As previously discussed, regret is often a negative emotion that we experience when realizing or imagining that the present situation would have been better had we acted differently. When this sample of practicing accountants are aware that earnings manipulation has occurred for either personal or corporate gains, they felt regret. Further, no statistical significance was found in either scenario for relief or satisfaction. H2 is supported. Further discussion is provided below.

We find that accountants feel regret when making a moral judgment about earnings manipulations. Controllers and managers face daily decisions that could impact the profitability of their organizations. Accountants are often aware of these decisions in their daily work. Ethical problems can arise when these decisions are not consistent with ethical norms of the individual or groups that an individual identifies with. Ethical problems can be further complicated by conflicting values, protecting one's personal self interest and balancing the needs of the organization and society with the anticipated outcomes. All decisions have outcomes that impact someone. Generally a person will feel positive emotions when a decision has positive outcomes and the opposite will occur if there are negative or unanticipated results.

Manipulating earnings can provide opportunities to obtain financing that could be used to expand operations or increase jobs, and in these rare situations, relief or satisfaction may be felt by those aware of the earnings manipulation. This group of accountants identified that these earnings management situations represent ethical problems and did not identify positive emotions with the action of earnings management. Taking a stance on ethical problems and having the courage to act against an unethical decision can create

anxiety. Often the outcomes of a decision are unknown and it is uncertain how peers and superiors would respond to someone who opposes an unethical decision.

Although there may be legitimate reasons to manage earnings, there are many examples where accounting manipulations evolved into major accounting frauds. These frauds caused significant financial losses to individuals, corporations, and society. An awareness of past outcomes and recalling the emotions one faced when becoming aware of these financial frauds may affect future decisions. The consequences of regret may involve an attempt to undo the negative outcomes of a decision, or when faced with a future ethical problem, those who anticipate or feel regret may be less likely to choose an unethical alternative.

CONCLUSIONS

Ethical judgment and decisions often involve balancing a variety of justifications, values and emotions. Emotions can be a beneficial factor when making an ethical decision. Feelings of regret when faced with choosing an unethical decision alternative may deter unethical choices. In comparison, feelings of relief and satisfaction may increase chances of choosing an ethical alternative or avoiding an unethical alternative. It is encouraging to find that when an accountant is aware of a problematic manipulation of earnings, they felt regret.

This is the first study to examine the effect of emotions on evaluations of earnings management. Generalizability of the results is limited by the sample size and geography; therefore, future studies may wish to increase the sample size and geographic regions of the participants. Even with these limitations, this study empirically confirms the significance of regret in making an ethical evaluation of what one should do when faced with an ethical dilemma of earnings management. In some ethical dilemmas, a wider range of emotions may be felt for varying scenarios. For example, in the case of environmental safety, empathy may impact ethical choice or in the case of accountants aware of unethical earnings management, fear of

retaliation may impact the choice to whistleblow. Future research may wish to consider the effects of these emotions, as well as feelings of anger and disappointment on ethical evaluations and intentions by accountants.

Studying the effects of emotions can have implications for ethics education. The evaluation of emotions in a classroom environment may help deter future unethical choices as students enter the accounting profession. Educators can play a significant role in helping students determine the appropriate course of action in any hypothetical ethical dilemma. Educators can use role-playing to highlight anticipated emotions when students evaluate both ethical and unethical decision alternatives. Further, developing feelings of empathy or sympathy for those affected by an ethical problem may deter unethical decision choices.

Table I
 Demographics

Age Range	N	%
19-29	7	4%
30-39	9	5%
40-49	40	23%
50-59	55	32%
Over 60	59	35%
Blank	1	1%
Total	171	100%

Table II
 Independent and Dependent Variables

Variables	Bad Debt		Early Shipment	
	Mean	Sd	Mean	Sd
Ethical Problem	1.888	1.508	2.000	1.465
Ethical Judgment (manager should not do action)	2.311	1.509	2.060	1.466
Relief if action completed	2.863	1.716	3.093	1.783
Regret if action completed	4.907	1.771	4.464	1.836
Satisfaction if action completed	2.758	1.676	3.179	1.804

Table III
 Regression Results for Emotions if Manager Completes Action

Scenario: Early Shipment
 Dependent Variable: What one should do

Model		β	t	p	ΔR^2
Step 1	Ethical Problem	0.457	6.485	0.000	0.209
			6.188	0.000	
Step 2	Ethical Problem	0.407	5.755	0.000	0.055
	Relief if manager completes action	-0.088	-1.129	0.261	
	Regret if manager completes action	-0.230	-3.202	0.002	
	Satisfaction if manager completes action	0.004	0.055	0.956	

Final R2 = .264; adjusted R2 = .245

Note: Predictors shown in bold are significant ($p < .05$) in the regression.

Table IV
 Regression Results for Emotions if Manager Completes Action

Scenario: Bad Debt
 Dependent Variable: What one should do

Model		β	t	p	ΔR^2
Step 1	Ethical Problem	0.655	10.576	0.000	0.429
			4.149	0.000	
Step 2	Ethical Problem	0.587	8.827	0.000	0.027
	Relief if manager completes action	-0.053	-0.759	0.449	
	Regret if manager completes action	-0.175	-2.652	0.009	
	Satisfaction if manager completes action	0.057	0.811	0.419	

Final R2 = .456; adjusted R2 = .441

Note: Predictors shown in bold are significant ($p < .05$) in the regression.

Appendix A
 Survey Excerpts

Bad Debt Scenario

The CEO of a company requests that the controller reduce the estimate for bad debts in order to increase reported income, arguing that this is a common practice in the industry when times are hard. Historically, the company has made very conservative (low) allowances for doubtful accounts, even in bad years. The CEO's request would make it one of the least conservative in the industry. **Action:** The controller makes the adjustment. Please **rate the request made by the CEO** using the following items:

The situation above involves an ethical problem.

Strongly Agree 1 2 3 4 5 6 7 Strongly Disagree

The controller should not do the proposed action.

Strongly Agree 1 2 3 4 5 6 7 Strongly Disagree

Please rate the emotions that your peers are likely to feel **if the controller makes the adjustment.**

Relief My peers wouldn't feel this at all 1 2 3 4 5 6 7 My peers would feel a great deal of this

Regret My peers wouldn't feel this at all 1 2 3 4 5 6 7 My peers would feel a great deal of this

Satisfaction My peers wouldn't feel this at all 1 2 3 4 5 6 7 My peers would feel a great deal of this

Early Shipment Scenario

A manager realizes that the projected quarterly sales figures have not been met, and thus the manager will not receive a bonus. However, there is a customer order which if shipped before the customer needs it will ensure the quarterly bonus but will have no effect on the annual sales figures. **Action:** the manager ships the order to ensure earning the quarterly sales bonus. Please **rate the request made by the manager** using the following items:

The situation above involves an ethical problem.

Strongly Agree 1 2 3 4 5 6 7 Strongly Disagree

The manager should not do the proposed action.

Strongly Agree 1 2 3 4 5 6 7 Strongly Disagree

Please rate the emotions that your peers are likely to feel **if the manager makes the adjustment.**

Relief My peers wouldn't feel this at all 1 2 3 4 5 6 7 My peers would feel a great deal of this

Regret My peers wouldn't feel this at all 1 2 3 4 5 6 7 My peers would feel a great deal of this

Satisfaction My peers wouldn't feel this at all 1 2 3 4 5 6 7 My peers would feel a great deal of this

*The entire survey can be provided upon request

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